



RSM China Certified Public Accountants  
中瑞岳华会计师事务所

# China Tax Highlights

November 2010

This Newsletter will introduce you with RSM's readings of the recent significant updates of China tax laws and regulations, including the contents, background and impacts of such changes.

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RSMi was founded in 1964, and now is the 6th largest network of independent accounting and consulting firms worldwide, with 736 offices in 76 countries, and more than 30,000 professional staff to serve clients worldwide.

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## I. FIE to Pay UMCT and Education Surcharges from 1 Dec

Based on Guofa [2010] No.35 the *State Council's Notice regarding Unifying Urban Maintenance & Construction Tax and Education Surcharge Regime of Foreign and Domestic Invested Enterprises and Individuals*, issued on 18 October, the Ministry of Finance (**MOF**) and the State Administration of Tax (**SAT**) jointly issued Caishui [2010] No.103, *Circular regarding Levying Urban Maintenance & Construction Tax and Education Surcharge on Foreign Capital Enterprises and Individuals* on 4 April, which stipulates that starting from 1 December 2010, Foreign Invested Enterprises (**FIE**), Foreign Enterprises and Individuals shall pay Urban Maintenance & Construction Tax (**UMCT**) and Education Surcharges after sixteen-year exemption.

UMCT and Education Surcharges are levied at flat rates on the paid Value Added Tax, Business Tax and Consumption Tax. UMCT rates are 7%, 5% or 1% depending on the enterprise's location; Education Surcharge is levied at 3% nationwide.

Thus far, all the tax regimes for foreign and domestic invested company have been united. Note-worthily, the Circular applies to foreign enterprises and individuals as well. Enterprises that pay service fees, interests, rentals or royalties etc. from China to overseas are obligated to withhold the UMCT and Education Surcharge as well as Business Tax.

## II. The Issuance of First and Most Detailed Interpretations of Tax Treaties

On 26 July, SAT issued *Interpretation of Agreement between the Governments of the People's Republic of China and the Republic of Singapore for the Avoidance of Double Taxation Protocol to the Agreement* (Guoshuifa [2010] No.75). The Circular provides the most comprehensive and detailed interpretations of the context of tax treaties up to date, including the practical mechanism in tax administration of non-resident. As stipulated by the Circular, if any other bilateral tax treaty has the same terms and conditions with Sino-Singapore tax treaty, the interpretations of the Circular will apply to the terms and conditions of such bilateral tax treaty as well. Hence, the Circular shall be regarded as a guideline on tax treaty issues.

The Circular addressed the detailed definitions and specific criteria of determination of the following concepts:

1. Permanent Establishment in relation to International Employment Assignment
2. Permanent Establishment in relation to operation place
3. Incomes of dividends, interests, royalties and equity transfer

### III. Lessee's Tax Treatments of Financial Sale and Leaseback

On 8 September, SAT issued *Notice regarding Certain Tax Issues for Lessee's Sale of Assets in Financial Sale and Leaseback Transactions* (Notice 13 of 2010). The Notice provides that the lessee's transactions of selling its own assets to a qualified financial leasing enterprise and instantly leasing the assets back for financing purposes should not be regarded as sale and leasing transactions from tax perspectives. Hence, the lessee is not liable for turnover taxes for such transactions. It is allowed to depreciate the assets all the same and deduct the relevant financing interests before tax.

Prior to the Notice, such transactions will be treated as two separate transactions, sale and leasing, which imply high turnover tax burdens for the lessee. The issuance of the Notice reflects the application of "substance over form" principles, making no difference between tax and accounting treatments for financial sale and leaseback transactions for lessee.

### IV. One-off Deduction of Equity Investment Loss Allowed

On 28 August, SAT issued *Notice regarding the Corporate Income Tax treatments of enterprise's equity investment loss* (Notice 6 of 2010). The Notice stipulates that the equity investment loss of an enterprise can be fully deducted before Corporate Income Tax (CIT) for the year when the loss is verified, starting from 1 January 2010. Such losses of the previous year's pending for deduction can be fully deducted in 2010.

Before the issuance of the Notice, some local tax authorities invoked the provisions of old CIT regimes in aspect of tax treatment for equity investment loss, e.g. the deductible loss for a year is not allowed to exceed the investment income of the year and the excess, if any, shall be carried forward.

### V. Audit-increased Tax Payable of Previous Years Allowed to Be Carried Back

On 27 October, SAT issued *Notice regarding the Issues on Carry-back of Audit-increased Tax Payable of Previous Years* (Notice 20 of 2010). The Notice confirmed that the previous year's tax payable increased in tax authorities' audit is allowed to be carried back to offset the tax losses of the year firstly.

Recently in the local tax practice of some areas, the tax authorities invoked the provisions of a tax circular under the old CIT regime, Guoshuifa [1997] No.191, to treat the audit-increased tax payable of previous years. Enterprises were asked to pay up the tax payable and relevant penalties and late charges as audit-increased tax payable was not allowed to be

carried back. The new Notice relaxed the tax treatments in this regard.

## **VI. Supplement to Pre-tax Deduction of Public Welfare Donation**

On 21 July, MOF, SAT and the Ministry of Civil Affairs jointly issued Caishui [2010] No.45, *Supplementary Circular regarding Relevant Issues on Pre-tax Deduction of Public Welfare Donation*. The Circular emphasized that only donation to or via the qualified social organizations or the county-level or above governments and their immediate organs is deductible before tax.

The circular also addressed that the qualification of the county-level or above governments are not required to be specially determined, while the qualification of social organizations shall be reapplied by themselves and released by governments on an annual basis.

## **VII. Tax Incentives Applicable for “Company + Farmer” Model**

On 9 July, SAT issued Notice 2 of 2010, *Notice regarding Corporate Income Tax Incentive Issues on “Company + Farmer” Model*. According to the Notice, although companies who conduct the designated “agriculture, forestry, animal husbandry or fishery” items in the form of “Company + Farmer” are not directly engaged in the items, they can enjoy the fully or 50% CIT exemption granted by CIT laws to such items.

## **VIII. Deed Tax and IIT Intensives of Real Estate Transactions Contracted**

On 29 September, MOF, SAT and the Ministry of Housing and Urban-rural Development jointly issued Circular on Adjusting Deed Tax and Individual Income Tax Incentives for Real Estate Transactions (Caishui [2010] No.94). The Circular continued the contractionary trend of tax incentives for real estate transactions from 2009. Compared with the previous regulations, the Circular provides more rigorous and strict conditions for individual’s enjoying the tax incentives for real estate transactions.

New rules	Previous rules
Deed Tax will be halved to the rate of 1.5% for individual's purchase of an ordinary house* which is the only house of the immediate family members including the individual, the spouse, and dependent children.	Deed Tax will be halved to the rate of 1.5% for individual's purchase of an ordinary house.
Deed Tax will be reduced to the rate of 1% for individual's purchase of an ordinary house beneath 90 Square Meter (inclusive) which is the only house of the immediate family members including the individual, the spouse, and dependent children.	Deed Tax will be reduced to the rate of 1% for individual's purchase of an ordinary house beneath 90 Square Meter (inclusive)
Individual Income Tax (IIT) will not be reduced or exempted for selling self-owned house and repurchasing house within one year.	For taxpayer who sells self-owned house and repurchases house within one year, IIT will be reduced or exempted partly or fully for the net amount of selling price minus repurchasing price.

\* The criteria of ordinary house may be different from location to location. For instance, Beijing addresses that an ordinary house is the one whose construction area is less than 140 Square Meters and whose price and plot ratio are qualified as stipulated.



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